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***FEDERAL PRISON INDUSTRIES', INC. STATUS AS A MANDATORY SOURCE
OF SUPPLY FOR FEDERAL GOVERNMENT PROCUREMENTS***

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EXECUTIVE SUMMARY

Title: Federal Prison Industries', Inc. Status as a Mandatory Source of Supply for Federal Government Procurements

Author: Major Roger L. McCreery, United States Army

Thesis: In today's competitive environment, where government agencies are pressured to adopt best commercial business practices with ever smaller budgets, it is arguable that the mandatory source legislation requiring the federal government to purchases goods from non-profit organizations such as National Industries for the Blind (NIB), National Industries for the Severely Handicapped (NISH), and Federal Prison Industries, Inc. (FPI) disproportionately influences/benefits these non-profit organizations by giving them an unfair advantage over vendors in the private sector. This paper will argue that the current legislation/system is deficient and that although the set-aside status for NIB and NISH is justified; in FPI's case, it is not warranted.

Discussion: Legislative statute requires the Federal Government to purchase specific goods and services from NIB, NISH, and FPI when offered at competitive prices. NIB/NISH provide numerous benefits to our citizens, and are quality suppliers, providing quality products on time at fair prices. Both organizations enjoy a strong legislative, social, and economic backing; it is highly unlikely that any legislation rescinding their mandatory source status would get sponsored in either House of Congress. FPI provides a correctional function for the Bureau of Prisons, with numerous benefits to not only prison operations, but also society as a whole. However, the statutory requirement to procure certain items from FPI circumvents the normal competitive process in business, and its associated benefits. In FPI's case, the "set-aside" status leads to the production and sale of an inferior product and, ultimately, a poor use of taxpayer's dollars. An amendment to the legislation requiring FPI to compete in a full and open environment would not only improve FPI's performance (quality, deliveries, service, and price), but allow its competition to effectively compete for federal government procurements as well. In addition, the potential to offset the eventual revenue loss in government sales a move to full and open environment would cause, could be offset by permitting FPI to pursue commercial sales as well.

Conclusions: Just as industry has changed it business operations to be competitive, in keeping with the theme espoused in the Defense Reform Initiative, so too must DoD continually upgrade its business operations to improve stewardship of DoD's fiscal resources and effectively support the warfighter. Requiring FPI to compete in a full and open competitive environment is a small piece of institutionalizing the defense reform advocated in current transformation literature. However, any additional legislation should not relieve FPI from eventually adopting best commercial business practices in order to become competitive in a full and open environment sometime in the future. It is clear FPI relies on mandatory source legislation for customers, and will continue to do so. What FPI should do, before it's mandated by customer demand and subsequent legislation, is rely on performance rather than a statute.

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"Is it justice that Federal Prison Industries would step on and take business away from a disabled Vietnam veteran who was twice wounded fighting for our country and give that work to criminals who have trampled on honest citizen rights; therefore effectively destroying and bankrupting that hero's business which the Veterans Administration suggested he enter."¹

CHAPTER I

Introduction

In today's competitive economic environment, where government agencies are pressured to adopt best commercial business practices with ever smaller budgets, it is arguable that the mandatory source legislation requiring the federal government to purchase goods from non-profit organizations such as National Industries for the Blind (NIB), National Industries for the Severely Handicapped (NISH), and Federal Prison Industries, Inc. (FPI) disproportionately influences/benefits these organizations by giving them an unfair advantage over vendors in the private sector. This paper will argue that the current legislation/system is deficient and that although the "set-aside" status for NIB and NISH is

¹ Quote from Mr. Roger English, ADM International's Sales Manager, at the June 27, 1996 hearing before the House Committee on Small Business, "Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries."

justified; in FPI's case, it is not warranted. The analysis will center on how the legislation affects FPI's environment. Specifically, the paper will analyze:

(1) FPI's mission(s) and role(s); (2) the impact of the legislation on the Bureau of Prisons (BOP); (3) the impact of the legislation on FPI's performance; (4) the impact of the legislation on FPI's competition; and (5) the impact of the legislation on the customer (both wholesale and retail). The research will conclude that the current system is deficient and recommend an alternative.

Background

Since the 1997 Defense Reform Initiative (DRI) Report was released, significant effort and progress have been made to bring competition and best commercial practices into the business of defense. The Department of Defense (DoD) is continually making progress in adopting 21st century business practices to meet the needs of U.S. warfighters. DoD has adopted a vision of becoming a world-class buyer of best value goods and services from a globally competitive industrial base. To accomplish this, DoD has incorporated the attributes of world-class commercial entities into its processes for

acquiring goods and services through aggressive acquisition and logistics reform. The goal is a system that provides the warfighter with goods and services better, faster, and cheaper.²

To meet the challenges of the future, DoD is transforming logistics from the mass model of the 20th century to a highly flexible, lean model for the 21st century. The military services and the Defense Logistics Agency (DLA) are making significant progress reducing supply inventory by improving equipment reliability, reducing logistics cycle time, selectively outsourcing weapon system support and functions, reducing supply retention levels, and shipping items directly to the end user by the vendor.³ DoD will continue to review and optimize logistics processes at all levels, adopting commercial solutions reflecting best industry practices where appropriate.

Under the Government-wide Federal Acquisition Regulation, nonprofit agencies such as NIB, NISH, and FPI are designated as required sources of supply for federal government purchasing. Although, in terms of the overall defense budget, any savings realized by scrutinizing these organizations would be minimal, reviewing their

² Report of the Secretary Of Defense to the President and the Congress, 2000.

processes is in keeping with the theme of DRI. The legislation mandating the Federal Government to purchase certain goods and services from workshops for the blind and severely handicapped, and from federal prison inmates when offered at competitive prices circumvents the normal competitive process. For DoD to experience the paradigm shift necessary to benefit from a true logistics revolution, even what appear to be small practices need to be questioned.

FPI was authorized by the Act of May 27, 1930 (ch. 340, 46 Stat. 391, 18 U.S.C. 744a-h). Public Law 92-28, the Javits-Wagner-O'Day Act (JWOD), established the Committee for the Purchase From People Who Are Blind or Severely Handicapped.⁴ The JWOD program's two central non-profit organizations, specifically NIB and NISH, enjoy a strong legislative, social, and economic backing. Based on this fact, it is highly unlikely that any legislation rescinding their mandatory source status would get sponsored in either House of Congress. Three examples shed a small amount of light on the support the JWOD program enjoys, beginning with the legislative history of Public Law 92-28.

³ SecDef Report to the President and the Congress, 2000.

The legislative history states:

The Wagner-O'Day Act has been a classic example of how, with a minimum amount of Federal assistance, a program was formulated under which actual recipients of public assistance (relief and welfare programs) were transformed into tax-paying citizens. Under the mechanisms of the Act the blind have been offered an opportunity to support themselves, and have thus gained personal dignity. There is a definite need to encourage the growth of the program in order to continue the betterment of the blind, and to extend the program to other severely handicapped and disabled.⁵

Today, thousands of men and women who are blind or have severe disabilities produce more than 2,000 products for the government. These products, made in America for America, also help people who are disabled become self-reliant members of society. NIB and NISH have established their reputations as quality suppliers by providing quality products on time at fair prices. Buying from NIB and NISH helps someone make a special contribution to society.

A 1995 DLA inter-office memorandum between the Small and Disadvantaged Business Utilization Office and

⁴ See Appendix A for the complete legislative and regulatory background of NIB, NISH, and FPI.

⁵ Public Law 92-28, 85 Stat. 77, Laws of 92nd Cong., 1st sess., 23 June 1971.

the Procurement Policy Directorate showed how conscious individuals and organizations are about the importance of continuing to support the JWOD Act. The memorandum describes the impact of a proposed exemption for the Department of Defense from the requirement to use NIB/NISH sources for purchases under the micro-purchase threshold of \$2,500 as follows:

To remove this class (purchases under \$2,500) of procurement from the JWOD program would produce very negative results for these employees. Preserving all JWOD opportunities ... is of special concern in the current era of downsizing... . It is critically important that we continue to support this Congressionally mandated program and strive to alleviate any negative impact that downsizing might bring on our less fortunate citizens. ... To advocate in favor of this proposed exemption would...set a bad precedent.⁶

Moreover, DLA's past record of proactive support of the JWOD Program was conspicuously noted by General Colin Powell, Chairman, Joint Chiefs of Staff, and the former Secretary of Defense Dick Cheney, in their reviews of its performance during Operations Desert Shield/Storm. To

⁶ Director, Small and Disadvantaged Business Utilization Office, Defense Logistics Agency, Inter-Office Memorandum, subject: "Applicability of Required Sources of Supply to the Micro-Purchase Threshold." 17 August 95.

endorse a proposal (the micro-purchase exemption) that DLA knows in advance would be injurious to the JWOD Program could only be detrimental to DLA's reputation.

Finally, the benefits of the JWOD program organizations are echoed at the highest level of the Federal Government. Former President Bill Clinton was quoted on April 20, 1993, saying, "Through the Javits-Wagner-O'Day Program, thousands of disabled Americans are given the opportunity to contribute more significantly to the American economy."

FPI, however, does not enjoy such a reputation. Small businesses in America, such as Standard Business Furniture of Washington, D.C. and Tennier Industries of LaFollette, TN, compete daily with federal inmates to provide a wide range of goods and services to the Federal Government. In many cases these small businessmen in the private sector provide superior products and services at lower cost and higher efficiency. A quote by Congressman Pete Hoekstra

(Republican-Michigan) at the June 27, 1996 House Committee on Small Business hearing, "Small Business Competition for

Federal Contracts: The Impact of Federal Prison Industries,"

typifies the attitude commercial businesses harbor towards FPI:

"At its heart the issue here is whether or not the federal government should be allowed to eliminate even the possibility of competition with private-sector firms and thereby substitute prison industry jobs for private sector jobs."⁷

The crux⁸ of their malcontent centers around the mandatory source status FPI enjoys. This standing leads to an inevitable question, is the set aside status warranted?

Obviously, the possibility of any proposed legislation to rescind the JWOD Act is remote. Nonprofit agencies employing the blind or severely disabled clearly fulfill the intended purpose of the legislation. Analyzing their standing is beyond the scope of this paper. However, it does not appear that FPI should be considered a benefactor of the same legislation as the agencies employing the blind or severely disabled.

⁷ U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., 27 June 1996.

⁸ crux (kruks, krooks) n., pl. 1. A crucial or vital moment; critical point. 2. The basic or essential thing. 3. A puzzling problem. [Latin, CROSS.]

CHAPTER II

This chapter will analyze FPI's mission and the impact of the mandatory source legislation on the Bureau of Prisons (BOP). FPI is a wholly-owned Government corporation, organizationally located within the Bureau of BOP, whose mission is to employ Federal prisoners by manufacturing products and providing services exclusively for other Federal agencies. FPI's policy is to provide employment for all physically fit inmates in United States penal and correctional institutions. In addition, FPI is responsible for diversifying prison industrial operations so that no single private industry is forced to bear an undue burden of competition from the products of the prison workshops. This aspect of their policy is designed to reduce, to a minimum, competition with the private industry or free labor.

Steve Schwalb, Assistant Director, Bureau of Prisons, opined before the House Committee on Small Business on June 27, 1996 that:

Since FPI is an essential program of the Federal Bureau of Prisons (BOP), I want to cite the mission statement of the BOP itself: to protect society by confining offenders in the controlled environments of prisons and community-based facilities that are safe, humane, and appropriately secure, and which provide work and other self-improvement opportunities to assist offenders in becoming law-abiding citizens. . . . the BOP considers FPI its most important correctional program.⁹

FPI's industrial plants employ up to 25% of all federal inmates capable of working, roughly 20,000 inmates in nearly 100 factories. The corporation manufactures some 85 different products, such as office furniture, work clothing, beds and linens, electronics equipment, traffic signs, and eyewear. In FY97, FPI was the 37th largest federal contractor, with 512.8 million in sales.¹⁰ In FY98, FPI's sales increased to 534 million, while it's standing among contractors rose to 35th.¹¹ Those physically fit inmates who do not work for FPI perform jobs related to running prisons, such as cooking cleaning, and laundry.

Within BOP there is established in the Treasury, a Fund. All proceeds and wages, less any taxes or

⁹ U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., June 27, 1996.

¹⁰ David Pace, "Prison industries drive Georgia manufacturer out of business," *Online Athens*, August 10, 1998.

¹¹ Kent Hoover, "Federal Prison Industries takes a bite out of business," *The Business Journal Phoenix*, 01 October 1999.

withholding required by Federal or State law, from prison labor performed by inmates under the supervision of the Attorney General shall be placed in the Fund. The Fund is used, under the guidelines established by the Attorney General, as follows:

- (1) One third is used to offset the costs of prisoner incarceration.
- (2) One third is used for victim restitution.
- (3) One tenth is held in a non-interest bearing account for the individual prisoner, to be paid on release from prison, but if the prisoner will not be eligible for release, then this portion shall be immediately available for use under subparagraph (2).
- (4) The remainder goes to States and local jurisdictions that operate correctional facilities to benefit the dependents of prisoners, but only to those States the Attorney General determines have substantially the same prison work system and prison conditions as established for Federal prisoners.

According to Mr. Schwalb, FPI provides an "absolutely critical function, with numerous benefits to prison operations and society as a whole."¹² The organization is the primary vehicle for meeting the BOP's statutory mandate to employ and train inmates. Both the BOP and FPI maintain the jobs provided by FPI reduce

¹² U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., 27 June 1996.

idleness, instill a work ethic, and provide training for the prisoners.

Additionally, FPI claims to be the BOP's single most important tool for ensuring order and safety within the overcrowded prisons. By reducing prisoner idleness and boredom, security of the correctional institution staff, the surrounding community, and the inmates themselves are enhanced. Finally, FPI claims that inmates who have worked in their programs are significantly more likely to maintain good conduct while incarcerated, find and retain employment upon release, earn higher wages, and avoid future involvement in crime. Although FPI is not forthcoming with statistics to back this claim it has congressional backing. According to Representative Bill McCollum(R-FL), "prisoners who make furniture or military uniforms are less likely to return to a life of crime than prisoners who do nothing during their time behind bars."¹³

The efforts/benefits of FPI were further articulated during a Hearing on H.R. 4100, "Free Market Prison Industries Reform Act of 1998," June 25, 1998, by Ms. Kathleen Hawk Sawyer, Director, Bureau of Prisons. She commented on three public policy objectives which are included in H.R. 4100.

¹³ Kent Hoover, "Federal Prison Industries takes a bite out of business," *The Business Journal Phoenix*, 01 October 1999.

First, FPI's goal is to employ as many inmates as possible in prison industry programs. Ms. Sawyer stated that this program employs 25 percent of inmates. She also stated BOP studies demonstrate that inmates employed by FPI are better behaved, and more likely to be employed.¹⁴

A second objective is to minimize any effect that FPI has on the private sector. Ms. Sawyer contended that FPI does not have a negative impact on the private sector. Instead, she reported that in the area of office furniture, industry sales have increased 20 percent in the last two years. The opponents of FPI assert that lower wages paid to inmates have adverse effects on the private industry. According to Ms. Sawyer, foreign imports are the main reason for the decline in the clothing/textiles manufacturing base, not FPI. She noted further that the lower wages allow them to employ more inmates, although the output of finished goods becomes less per inmate.

Finally, Ms. Sawyer suggested that FPI reduces the burden on the taxpayer because FPI pays all operating costs from its sales. The organization also requires workers to pay 50 percent of their earnings toward court-ordered obligations. In addition, the program results in more successful inmate re-integration into society.

¹⁴ Hearing on H.R. 4100 "Free Market Prison Industries Reform Act of 1998," and H.R. 2758 "Freedom Prison Industries Competition in Contracting Act of 1997," 25 June 1998.

Clearly, in Ms. Sawyer's opinion, FPI not only benefits BOP as a whole but the prisoners and taxpayers as well.

Recent "rehabilitation" data for the California justice department, however, contradicts FPI and BOP's claim of successfully re-integrating a high number of inmates into society. 68% of prisoners incarcerated in that state's penal facilities are repeat offenders.¹⁵ Similar statistics are prevalent in other states as well.

Mr. Roger English, Sales Manager, ADM International, also questioned the validity of FPI's claims in his testimony at the June 27, 1996 hearing before the House Committee on Small Business. He claimed:

[that FPI's argument is it] needs to teach work ethics to the convicts and give them a trade.
You
workers
work.
exactly
is
prison
guards).¹⁶

can't teach work ethics by having too many
and taking too long a time to do too little
I have visited their factories and that is
the situation that I have observed. Further it
impossible to get any statistics concerning
released convicts getting jobs in their prison-
trained skills. ... FPI needs to keep convicts
working to keep them out of trouble in prison -
(and here I thought that was the duty of the

¹⁵ Fox Butterfield, "Often, Parole Is One Stop On The Way Back to Prison," *The New York Times*, 29 November 2000, Final Ed., A1., (pp. 1, 28)

¹⁶ U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., 27 June 1996.

Although these accounts are markedly different, the issue is whether FPI can provide benefits to BOP and society if it did not enjoy its set aside preference? The short answer is yes, but probably not to the current level. FPI is chartered to provide a service for the BOP, the legislation gives FPI the ability to contend with private industry in sales. Without some type of preference, FPI would not be able to compete given its charter to employ as many prisoners as possible, making as many products as possible. These two characteristics do not lend themselves to running a profitable business enterprise.

In all likelihood a change in legislation would cause the number of employment positions available to decrease due to an inevitable loss in government sales that a move to a full and open competitive environment would cause. But if FPI were not only required to compete for government sales but permitted to pursue private business as well, there lies the potential to offset the potential loss in government sales for FPI. The potential increase in customers, and ultimately in revenue, could offset the expenses associated with streamlining operations to become more efficient and cover the eventual loss in government purchases. Consequently, the number of jobs could stay the same, or possibly increase. Also, the additional profits from

sales to private industry could be used for other rehabilitation programs within BOP.

However, if FPI could not recover the revenue lost in government sales, to combat the increase in inmate idleness, BOP would have to initiate additional programs to constructively occupy their time. This, in turn, would cause Congress to appropriate more money to the BOP's budget. But, in a time of smaller budgets and shrinking government, an appropriations increase seems unlikely.

CHAPTER III

This chapter will analyze the impact of the mandatory source legislation on FPI's performance and competition. With respect to its performance, FPI enjoys a unique situation because of its mandatory source status. According to Congressman Pete Hoekstra (R-MI) :

...through the mandatory source rule, [FPI] is able to flip the normal seller-buyer relationship on its head. Only in this odd situation does the seller, FPI, have the authority to tell the buyer, the Federal Government and American taxpayers, from whom it can purchase products and services. In normal commercial dealings the seller must convince the buyer to part with his funds in order to purchase the seller's product. In the federal system, all FPI has to do is say, 'We can supply the product you are looking to buy. You must purchase the product from us'.¹⁷

In effect, FPI has no competition, which has adversely affected its performance. Basically, because of its mandatory source status, FPI has no incentive to improve its quality or service. When reviewing performance data, FPI shows a pattern of delinquencies, high prices, and poor workmanship. The following examples illustrate this phenomenon.

A mechanism the Defense Logistics Agency (DLA) uses to evaluate contractors, i.e. FPI, is the Automated Best Value Model (ABVM). The ABVM is an automated system,

¹⁷ U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., 27 June 1996.

which collects a vendor's existing past performance data and translates it into a numeric score. The contracting officer then uses this as an additional evaluation factor in the best value award decisions. The ABVM score is a combination of an offeror's quality and delivery scores.

Using the ABVM, FPI's performance for FY92-FY94 was dramatically worse than other vendors. Delivery delinquencies far out numbered quality conformances. The problems were concentrated in the percentage of lines delivered on time (percent on time rating was below 50%) and failure to deliver at all.¹⁸ A snapshot in November of 1996 revealed similar findings. Of the 85 or so product lines FPI produced at that time, 70% were below the industry average in delivery, with nearly all falling 10% points or higher behind commercial providers.¹⁹ With such performance, if given a choice, it seems the customer would go elsewhere with its business. But, because FPI receives the business (contract award) whether or not they have poor ratings, they have no incentive to be concerned about their ratings.

Similarly, the Deputy Commander of DLA, wrote in a May 3, 1996 letter to the U.S. House of Representatives that FPI has had a 42 percent delinquency rate in its clothing and textile deliveries, compared to a 6 percent

¹⁸ Chief, DLA Operations Research Office, Defense Logistics Agency, Inter-Office Memorandum, subject: "Federal Prison Industries (FPI), National Industries for the Blind (NIB), and National Industries for the Severely Handicapped (NISH) Performance (Consultation Number DLA-95-C50126.)"

¹⁹ Defense Supply Center Richmond, Inter-Office Memorandum, subject: "ABVM Ratings for FPI and NIB/NISH." 26 November 1996.

rate for commercial industry. For this record of poor performance, FPI has charged prices that were an average of 13 percent higher than commercial prices.

In addition, two other situations were discussed by Ms. Sheri Lake, American Society of Interior Designers (ASID), at the House Small Business Committee Hearing on June 27, 1996. She commented:

At Immigration and Naturalization Services, an [FPI] systems furniture order was over 14 months to delivery and arrived with many missing parts.
My client has tried over and over again to get the missing parts to finish the installation. To this date, almost 2 ½ years after the order was placed, they still do not have a completed installation. At US Coast Guard [FPI] upholstered lounge pieces took over 24 months to arrive. Then when they did, the sofa was missing a leg. Once again, the service was not there to take care of the problem. To this day, the sofa sits at (the) Coast Guard (installation) with a stack of books holding up one end.²⁰

Other federal government customers of FPI wish they could buy from someone else as well. Richard M. Coyle, a supervisor in the safety division at the Marine Corps base in Quantico, Va., says he is required to buy safety glasses from FPI, "which can take up to eight weeks for

²⁰ U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., 27 June 1996.

delivery and at a higher cost. If I were allowed to buy them from a local optometrist, I could get them in two or three days at a lower cost." Mr. Coyle goes to state that the mandatory source requirement "ties agencies' hands when it comes to making smart purchasing decisions."²¹

Conversely, Mr. Schwalb believes that FPI's mission as a correctional program takes priority over its nature as a business enterprise. A phenomenon/circumstance that could partially explain its poor performance. Because FPI's statutory mandates embody public policy obligations rather than traditional business principles, they are unable to operate like all for-profit, private sector businesses. FPI seeks to maximize inmate work opportunities. By contrast, private sector businesses seek to reduce work force levels. Additionally, private businesses focus on a limited product line, whereas FPI is involved in a large number of products and services in the interest of minimizing its impact on any one industry. Finally, private businesses seek to streamline manufacturing processes. FPI, however, provides work programs for a growing inmate population, which unavoidably restricts productivity.

On the other hand, there is a strong belief that requiring FPI to compete in a full and open environment

²¹ Kent Hoover, "Federal Prison Industries takes a bite out of business," *The Business Journal Phoenix*, 01 October 1999.

would improve quality, deliveries, service, and price.

As Congressman Hoekstra (R-MI) stated:

Federal Prison Industries should be required to compete with private sector business on the basis of price, quality, delivery and design, rather than being able to insulate itself from competition and dictate the share of the markets it wishes to supply. Repeal of mandatory source status guarantees that this competition will occur. Through this competition, FPI will be forced to earn its business by performing in a timely manner, offering a competitive price and delivering a product of quality and value for the limited federal procurement dollar.²²

As a result, the issue is whether FPI would be able to perform at a satisfactory level, given its current statutory mandates as a correctional program, in a full and open competitive environment. At first glance it seems apparent that competition would force FPI to improve its performance. It would only seem logical that competition would cause FPI to improve quality, delivery, and price to ensure customer satisfaction and, ultimately, sales. While this may be true, FPI really has no reason to do so, for it appears capable of monopolizing the market on selected items. Unless there is a change from FPI's obligation to be a correctional

²² U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., June 27, 1996.

program, they will not be able to effectively compete over the long run. FPI enjoys its mandatory status for that specific reason, it is a correctional program. The legislation is the mechanism that creates business opportunities for FPI, without causing them to engage in massive sales and marketing activities.

The affect on FPI's competition is just as adverse. According to Congressman Pete Hoekstra (R-MI), if the current mandatory source legislation stays in place, the effect on FPI's competition will continue to be devastating. The issue here is whether or not even the possibility of competition with private-sector firms should be eliminated by the federal government by substituting prison industry jobs for private sector jobs. This sentiment echoes throughout private industry and typifies the resentment commercial businesses harbor towards FPI.

There are many instances of people losing jobs or companies going out of business. Just one account was given at the June 27, 1996 hearing before the House Committee on Small Business, where Mr. English, ADM International's Sales Manager gave a rather emotional account of the effects. He testified:

Is it justice that Federal Prison Industries would step on and take business away from a disabled Vietnam veteran who was twice wounded fighting for

our country and give that work to criminals who have trampled on honest citizen rights; therefore effectively destroying and bankrupting that hero's business which the Veterans Administration suggested he enter. ... Incidentally, his product was far superior and more environmentally protective than the products being forced into government facilities by Federal Prison Industries.²³

According to Representative Van Hilleary (R-TN), "throwing law-abiding citizens out of work in favor of convicted criminals dangerously undermines the American dream and everything our nation is about."²⁴

However, the issue then is two-fold and, again, not easy to answer. First, can FPI's competitors continue to survive with the current legislation? Second, if FPI were required to compete in a full and open competitive environment would they be able to contend on the resultant level playing field? If the legislation stays as is, some of FPI's competition will get muscled out. By all accounts, the markets that FPI are in will continue to exist, but as the size of the market declines, the absolute preference has a devastating effect on private industry, especially where federal requirements predominate. Ultimately, only the strong will survive to contend for federal procurement dollars.

²³ U.S. Congress. House, Committee on Small Business, *Small Business Competition for Federal Contracts: The Impact of Federal Prison Industries*, Hearings, 104th Cong., 1st sess., June 27, 1996.

²⁴ Kent Hoover, "Federal Prison Industries takes a bite out of business," *The Business Journal Phoenix*, 01 October 1999.

Based on their performance, it would appear that the only way FPI can compete is because of the current legislation. If FPI is required to compete in a full and open competitive market and the legislation does not change, they will by all accounts, fall on their legislatively mandated sword.

CHAPTER IV

This chapter will analyze the impact of the mandatory source legislation on FPI's customer. The impact the legislation has on FPI's retail customer is relatively easy to determine. The bottom line is in many cases the ultimate customer is paying too much for an inferior product. The Immigration and Naturalization

Service having to wait over 2 ½ years for the complete installation of a systems furniture order is one illustration. The U.S. Coast Guard waiting over 24 months for an upholstered lounge furniture order, only to have it arrive incomplete, is another. And, finally, Mr. Coyle's account of safety glasses at Quantico costing more and taking 53 days longer than a commercial vendor could provide, show how desperate it is for some of FPI's customers. And these are just a few examples of second-class service/workmanship. The impact the mandatory source status has on the wholesale customer, however, is a little more difficult to define.

The private sector, driven by today's globally competitive business environment, is faced with the challenge of improving its product/service while lowering costs. As a result, many companies have adopted innovative business practices to meet customer needs and retain profitability. Since DoD is facing a similar challenge of providing better service at a lower cost, it has begun to reexamine its business practices. Due to the pressures of budgetary limits, DoD must seek new and innovative ways to make logistics processes as efficient and effective as possible.²⁵ Defense Reform Initiative concepts such as World-Wide Express, Focused Logistics, Integrated Logistics Capability, and Precision Logistics

²⁵ Charles I. Patton, Jr. and Kenneth R. Krouse, Jr., *Inventory Management: Adopting Best Practices Could Enhance Navy Efforts to Achieve Efficiencies and Savings*, GAO/NSIAD-96-156, April 1996.

are pursuing better ways of doing business. For the paradigm shift to take place throughout DoD logistics all processes should be considered candidates for transformation.

However, DoD currently has legal, financial, and mission restrictions that may make it difficult, if not impossible, for it to adopt best commercial business practices. For example, achieving improved performance often requires up-front capital to invest in new technology and a flexible labor force, both of which may be more tightly constrained for DoD. Also, DoD must retain capabilities for wartime surges that create slack (in material, labor, or capacity) in logistics processes, making it more difficult to introduce the daily stresses that lead to incentives for continuous improvement.

Despite these restraints, DLA (one of FPI's largest wholesale customers) is leading DoD in business practice reengineering and leveraging technology in order to redesign logistics processes. However, there is concern over regulations governing procurement. In a memorandum, dated April 1995, to Dr. John P. White, Chairman, Commission on Roles and Missions of the Armed Forces, the former Director of DLA, VADM(Ret) Edward M. Straw expressed his thoughts about regulatory restrictions hampering DLA's reengineering efforts as follows:

...even though recent acquisition reform

legislation made great strides, there are still statutory requirements that hamper our ability to take full advantage of what the commercial sector has to offer. Paramount among these are: domestic source restrictions; *mandated sources of supply*; small business set aside and subcontracting plan rules; and Cargo Preference Act restraints. ... The Statutory requirement to procure certain items only from... the Federal Prison Industries circumvents the normal competitive process.²⁶

In addition, mandatory source requirements can create delays in the procurement process when the mandatory source cannot meet the DLA's immediate requirement (e.g., delivery schedule, quantity and/or quality), due to the protracted nature of the process, which must be completed prior to the DLA being permitted to procure from commercial sources. Furthermore, use of a Purchase Card to reduce administrative costs by quickly and easily acquiring supplies from a local vendor is impeded by the need to first determine whether the item has a mandatory source of supply. DoD customers should be given the flexibility to compete their requirements among all available sources

²⁶ Director, Defense Logistics Agency, letter to Chairman, Commission on Roles and Missions of the Armed Forces, 06 April 1995.

and be permitted to use the procurement method that best suits their needs.

As Captain Pete Eltringham (USN), former Assistant Executive Director, Business Practice Reengineering, DLA, commented, "the 21st Century customer will demand the 'dimension of value' of a product or market that he wants at the particular time of a procurement." In other words, a customer wants what is most important to him at the time of

purchase. A customer's priorities will vary depending on what his or her needs are at a particular time. Most notably, these priorities will shift between price, quality, and delivery time. Providing that choice to the customer is the key to success. The bottom line is the customer will demand it. What DLA is looking to do is be DoD's one stop shop. To do so they must be afforded the flexibility to use the best procurement method available and ultimately pass that value onto the customer. Purchasing substandard products at inflated prices is hardly conducive to that strategy.

The issue centers on FPI's ability to provide the customer what it wants at the time of purchase. The research indicates it cannot. But, in its current environment, FPI doesn't have an incentive to meet those

consumer needs because their customers are shackled to them. As a result, the products/services the customer(s) ultimately receives will, in all likelihood, remain overpriced and inferior compared to those offered in private industry.

CHAPTER V

Conclusion

Under legislative statute and the Government-wide Federal Acquisition Regulation, FPI is designated as a required source of supply for federal government purchasing. This paper has explored FPI's environment with respect to that mandatory source status. Specifically, the affects the legislation has on FPI's mission, performance, competition, and customer were examined.

With most legislation there are proponents for both sides of an issue and it's the lawmakers challenge to find the compromise. The research indicates there is no clear-cut answer to whether FPI should or should not enjoy the same mandatory source legislation as agencies that employ the blind and severely disabled. Each side to the argument stands pat on their particular view. On one hand the mandatory source legislation does allow FPI to meet its statutory mandate and employ as many physically fit inmates as possible, bringing numerous benefits to many associated with BOP. However, it is apparent there is a growing sentiment to rescind the legislation because of the hardship it causes to many of FPI's competitors and customers. There are three possible alternatives for lawmakers to consider: leave

the current legislation in place; rescind the current legislation in total, requiring FPI to compete in a full and open environment for all products; or amend the current legislation and/or regulations.

Research supports the notion that something needs to be done and the current legislation cannot remain *as is*. Instances of unfair competition are too plentiful, private industry is just growing more discontented and Congressional interest is peaking. The June 27, 1996 Congressional hearing brings to light just a few of the legitimate concerns faced by small businesses in the furniture business. Many of FPI's competitors in other commodities, such as clothing and electrical equipment, face the same valid challenges/hardships. The Statutory requirement to procure certain items from FPI circumvents the normal competitive process.

Rescinding the legislation is in line with DRI, as well as the National Performance Review recommendation that government should take away the Federal Prison Industries status as a mandatory source of federal supplies and require it to compete commercially for federal agencies' business. Reforming all of DoD's business practices is essential to improving stewardship of its fiscal resources and must not become passé. Just as industry changed its business operations to be competitive, so too must DoD continually upgrade its business operations to effectively support future

national security strategies.²⁷ Requiring FPI to compete in a full and open competitive environment would help institutionalize the defense reform espoused in current transformation literature. But it appears without significant Congressional backing, in FPI's case, the result could cripple the organization, severely affecting both BOP and the prisons. In order to successfully rescind the legislation, the following would have to happen.

Congress must lift the many conflicting mandates and constraints inherent with FPI being a correctional program in order for it to compete in the commercial sector. In addition, Congress must also be willing to help FPI become competitive in the 21st Century, i.e. Electronic Commerce/Electronic Data Interchange capability, in order to effectively compete. Congress may also have to subsidize FPI's prices to ensure they are competitive with commercial producers. Finally, Congress must be willing to increase the Bureau of Prisons' appropriations to offset the inevitable loss in sales FPI will endure until it can compete with the quality and prices found in the commercial sector. Although the loss in government sales could be offset if, in addition to rescinding the mandatory source status, Congress passed legislation permitting FPI to compete for private business sales as well as government purchases.

²⁷ SecDef Report to the President and the Congress, 2000.

The resulting increase in sales would not cause as large a Congressional backing of dollars, as removing FPI's mandatory source of supply status surely would.

However, with today's budget constraints and the previously mentioned stipulations it is unlikely that Congress will rescind the legislation totally.

Conversely, leaving the legislation in place is also not an option. The statutory requirement to procure certain items from FPI circumvents the normal competitive process in business, and its associated benefits. The research shows that, in FPI's case, the set-aside status leads to the production and sale of an inferior product and a poor use of taxpayer's dollars. Not only is FPI's customer adversely affected, but its competition is enduring hardship as well. Numerous businesses, unable to obtain Federal Government procurement contracts because of FPI's status as a required source of supply, are closing their doors. The only possible solution to the situation is a compromise, an amendment to the current legislation.

Before discussing an amendment to the legislation, it is important to note that the federal government and small businesses in private industry can help themselves in another way. A small number of FPI's products are considered mobilization items, requiring a strong industrial base, and/or "combat critical" items, (i.e. communication cables). Once a requirement is identified it is imperative that these items are received in a

timely manner. Obviously, sub-standard delivery times are unacceptable and degrade military readiness. A policy identifying these critical items and removing them from FPI's Schedule of Products is a compromise that does not require further legislation. To maintain sales in these particular commodities, FPI would compete in a full and open environment with private industries. Federal agencies would be able to pick the best value for the taxpayer's dollar. By removing the requirement for a federal agency to use mandatory sources for these products, dollars would be spent more efficiently and combat readiness would not be compromised.

In 1996, Congresswoman Jan Meyers and Congressman Peter Hoekstra in the House, along with Senator Carl Levin and Senator Spencer Abraham in the Senate drafted an amendment to the legislation (Levin Amendment No. 778). Basically, the bill removed some items from FPI's Schedule of Products and limits FPI's market share of a particular product to a certain percentage. The bill called for the removal of FPI's position as the mandatory place for every federal government agency to buy products. It also required FPI to assign classification numbers to all of its products, and considered 20% as a reasonable share of the federal market. This would ensure FPI does not dominate the federal market while still providing FPI with a mandated customer base. It could also cause FPI to improve its performance because

it would compete for 80% of the consumers in a particular commodity.

During the 105th Congress the amendment was rejected, 182-244. However, an amendment requiring the Department of Defense and FPI to conduct a joint study of existing procurement procedures, regulations, and statutes that now govern procurement transactions between the Department of Defense and FPI to the bill did pass. The study resulted in the submission of another version of an amendment, sponsored by Representative Hoekstra (R-MI), to the 106th Congress, H.R. 2551. The latest version of the bill proposes to require FPI to compete its Federal contracts to minimize unfair competition with private firms (depriving law-abiding workers of job opportunities). It proposes a savings of taxpayer dollars by empowering Federal contracting officers to acquire commercial products that better meet agencies' needs, more quickly and at less cost without having to obtain permission from FPI. And, finally, to further empower contracting officers to compel FPI to fully perform its contract obligations to the same extent as all other contractors.

What seems inevitable is that some type of legislation will pass soon. However, any additional statute or amendment should not relieve FPI from eventually adopting best commercial business practices and grasping emerging technologies in order to become

competitive in a full and open environment sometime in the future. It is clear FPI relies on mandatory source legislation for customers, and will continue to do so. What FPI should do, before it's mandated by customer demand and subsequent legislation, is rely on performance rather than a statute.

APPENDIX A

Legislative and Regulatory Background

The Wagner-O'Day Act (41 U.S.C. 46-48) of June 25, 1938 created a Committee on Purchases of Blind-Made Products to provide employment opportunities for the blind in the manufacture of products to be sold to the Federal Government. The Committee for the Purchase From People Who Are Blind or Severely Disabled was established by the Javits-Wagner-O'Day Act (JWOD), Public Law 92-28, 85 Stat. 77 (1971), as amended, 41 U.S.C. 46-48c. The JWOD amended the Wagner-O'Day Act to include the severely disabled. Title 41, Chapter 51 of the Code of Federal Regulations (CFR) mandates that the Federal Government increase employment and training opportunities for persons who are blind or have other severe disabilities through the purchase of commodities and services from qualified nonprofit agencies. It is the policy of the "Committee" to encourage all Federal entities and employees to provide the necessary support to ensure that the JWOD Act is implemented in an effective manner. FPI was authorized by the Act of May 27, 1930 (ch. 340, 46 Stat. 391, 18 U.S.C. 744a-h). FPI's policy is to provide employment for all physically fit inmates in United States penal and correctional institutions.

In addition, Title 41, Chapter 51 of the CFR establishes the following mandatory source priorities:

(1) The JWOD Act mandates that commodities or services on the Procurement List¹ required by Government entities be procured, from a nonprofit agency employing persons who are blind or have other severe disabilities, at a price established by the Committee, if that commodity or service is available within the normal period required by that Government entity.

(2) Federal Prison Industries, Inc. has priority, under the provisions of 18 U.S.C. 4124, over nonprofit agencies employing persons who are blind or have other severe disabilities in furnishing commodities for sale to the Government. All or a portion of the Government's requirement for a commodity for which FPI has exercised its priority may be added to the Procurement List. However, such addition is made with the understanding that procurement under the JWOD Act shall be limited to that portion of the Government's requirement for the commodity which is not available or not required to be procured from FPI.

(3) The JWOD Act requires the Committee to prescribe regulations providing that, in the purchase by the Government of commodities produced and offered for sale by qualified nonprofit agencies employing persons who are blind and nonprofit agencies employing persons who have

¹ Procurement List means a list of commodities and services which the Committee has determined to be suitable to be furnished to the Government by nonprofit agencies for the blind or nonprofit agencies employing persons with severe disabilities pursuant to the JWOD Act.

other severe disabilities, priority shall be accorded to commodities produced and offered for sale by qualified nonprofit agencies for the blind. In approving the addition of commodities to the Procurement List, the Committee accords priority to nonprofit agencies for the blind. Nonprofit agencies for the blind and nonprofit agencies employing persons with severe disabilities have equal priority for services.

The Federal Acquisition Regulation, Part 8 establishes the use of all Government supply sources in the following order of priority:

(1) Supplies.

- (a) Agency inventories;
- (b) Excess from other agencies;
- (c) Federal Prison Industries, Inc.;
- (d) Products available from the Committee for Purchase From People Who Are Blind or Severely Disabled;
- (e) Wholesale supply sources, such as stock programs of the General Services Administration (GSA), the Defense Logistics Agency, the Department of Veterans Affairs, and military inventory control points;
- (f) Mandatory Federal Supply Schedules;
- (g) Optional use Federal Supply Schedules; and
- (h) Commercial sources (including educational and nonprofit institutions).

(2) Services.

(a) Services available from the Committee for Purchase From People Who Are Blind or Severely Disabled;

(b) Mandatory Federal Supply Schedules;

(c) Optional use Federal Supply Schedules; and

(d) Federal Prison Industries, Inc., or commercial sources (including educational and nonprofit institutions).

Additionally, Subparts 8.6 and 8.7 to Part 8 of the Federal Acquisition Regulation establish acquisition procedures and identify purchase exemptions/waivers for FPI and nonprofit agencies employing people who are blind or severely disabled. Clearances are required from FPI before supplies on the Schedule are acquired from other sources. FPI clearances ordinarily are of the following types:

(a) General or blanket clearances issued when classes of articles or services are not available from FPI; or

(b) Formal clearances issued in response to requests from offices desiring to acquire, from other sources, supplies listed in the Schedule and not covered by a general clearance.

FPI clearances are not required when:

(a) Public exigency requires immediate delivery

or performance;

(b) Suitable used or excess supplies are available;

(c) Purchases are made from General Services Administration (GSA) of less-than-carload lots of common items stocked by GSA;

(d) The supplies are acquired and used outside the United States; or

(e) Orders are for listed items totaling \$25 or less that require delivery within 10 days.

Purchase exceptions are granted for items on the Procurement List by the designated central nonprofit agency when:

(a) The JWOD participating nonprofit agencies cannot provide the supplies or services within the time required, and commercial sources can provide them significantly sooner in the quantities required; or

(b) The quantity required cannot be produced or provided economically by the JWOD participating nonprofit agencies.

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18 U.S.C. sec. 4121-4128.

41 U.S.C. sec. 46-48c.

41 C.F.R. Chapter 51.

Federal Acquisition Regulation, Part 8.

